
Foreign Military Sales Administrative Surcharge Reduction

By

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Abstract

This article discusses the rationale for changing the Foreign Military Sales (FMS) administrative fee and the benefits to be derived from the change. The recommendation to change the rate was based on financial analysis targeting FY 2007 to accomplish income/expense rationalization, administrative account continued solvency, and infrastructure changes through reengineering. The article concludes that the decision to change the administrative fee shows the DoD's commitment to making needed changes to the FMS processes and infrastructure.

Introduction

As part of the Department of Defense (DoD) review efforts to meet the challenges of the coming millennium, one of the areas under review is reinventing the way the DoD manages FMS. Executives from government and industry, in concert with foreign national representatives, have been discussing various aspects of the FMS program over the past year. These discussions were openly shared with the security cooperation community during the Defense Security Cooperation Reform Day on 10 June in Alexandria, Virginia.

In a speech presented at this conference, James M. Bodner, Principal Deputy Under Secretary of Defense for Policy and Counselor to the Secretary of Defense, underscored the importance of security cooperation and indicated that FMS is too valuable a tool to allow it to become ineffective. [This speech is found in its entirety on page 50.] Bodner stated the following:

For the U.S. government, FMS is a critical element supporting our national security and foreign policy objectives. For our international customers, FMS brings tremendous benefits as well. For U.S. industry, FMS provides a structure that ensures American companies get paid. From a policy perspective, FMS clearly is an indispensable tool.

Operating within the broader context of the DoD's goal of bringing best business practices and greater efficiency to the Department, the Defense Security Cooperation Agency (DSCA), in concert with the U.S. military departments (MILDEPs), have begun developing and implementing programs and strategies for making FMS more customer-friendly and more cost effective, while keeping in mind its primary goal of being an instrument of foreign policy.

One such strategy that the DSCA has implemented as a result of its early reinvention efforts is the lowering of the FMS administrative fee from 3 percent to 2.5 percent. Against this background, the purpose of this article is twofold: (1) to discuss the rationale for changing the FMS administrative fee, and (2) to discuss the benefits to be derived from a change in the FMS administrative fee.

Background

The Arms Export Control Act, Section 21(e) (1) states that letters of offer for the sale of defense articles or for the sale of defense services shall include appropriate charges for

...administrative services, calculated on an average percentage basis to recover the full estimated costs (excluding a pro rata share of fixed base operations costs) of administration of sales made under this Act to all purchasers of such articles and services....

Additionally, the Financial Management Regulation 7000.14-R, Volume 15, paragraph 030210.G, assigns the responsibility for FMS administrative rate change recommendations to DSCA, with approval by the DoD Comptroller.

The FMS administrative surcharge is reviewed on an annual basis, and this review considers factors that are current and relevant at the time. Normally, adjustments are only made when fairly significant changes in future trends are forecasted. The administrative fee has remained unchanged over the past two decades. In fact, DoD last changed the FMS administrative rate in 1977, from 2% to 3%.

Discussion

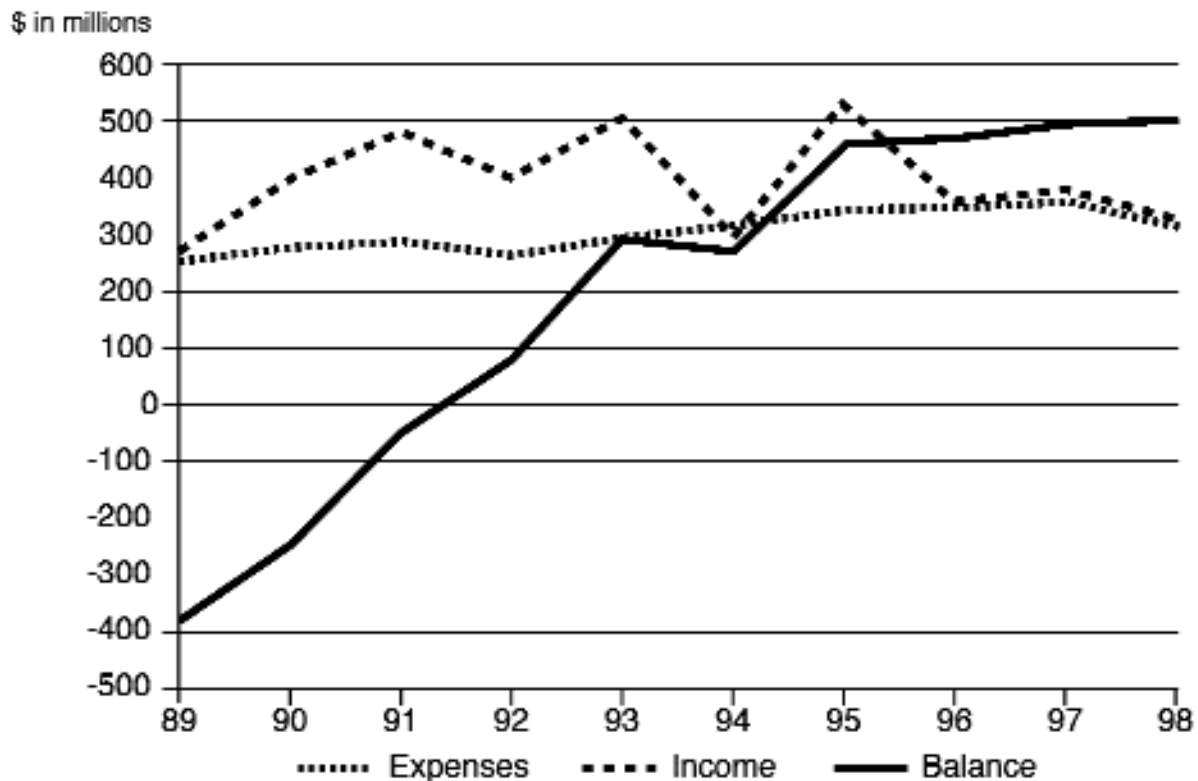
In June 1999, the DSCA recommended a reduction of the administrative surcharge to 2.5%, which was subsequently approved. The rate change applies to all new cases and to new lines established on existing cases implemented on or after 1 June 1999. Implementation instructions have been developed and were provided to the military departments and the Security Assistance Organizations (SAOs) throughout the world. These implementing instructions may be found on page 138. Several factors, such as the current balance of the administrative account, coupled with anticipated increased sales and reduced FMS operating costs through reinvention efforts, supported the rate reduction. These component elements are discussed in the sections below.

Income/Expense Rationalization

The DSCA develops worldwide security cooperation budgets, in conjunction with the MILDEPs and defense agencies, based on long-term sales trends and corresponding resource requirements. Table 1 gives a historical account of the administrative fund over the past ten years. As shown, administrative income has either exceeded or equaled expenditures every year from FY 1989 through FY 1998. Table 1 further shows that the balance in the administrative fund climbed to nearly \$500 million in both FY 1997 and FY 1998. This balance increases when income exceeds expenditures. The balance is used to fund work to be performed on open cases and as a safety factor to fund the completion of programs.

The data in Table 1 indicate that the financial posture of the administrative fund is healthy and strong.

Table 1
FMS Admin History



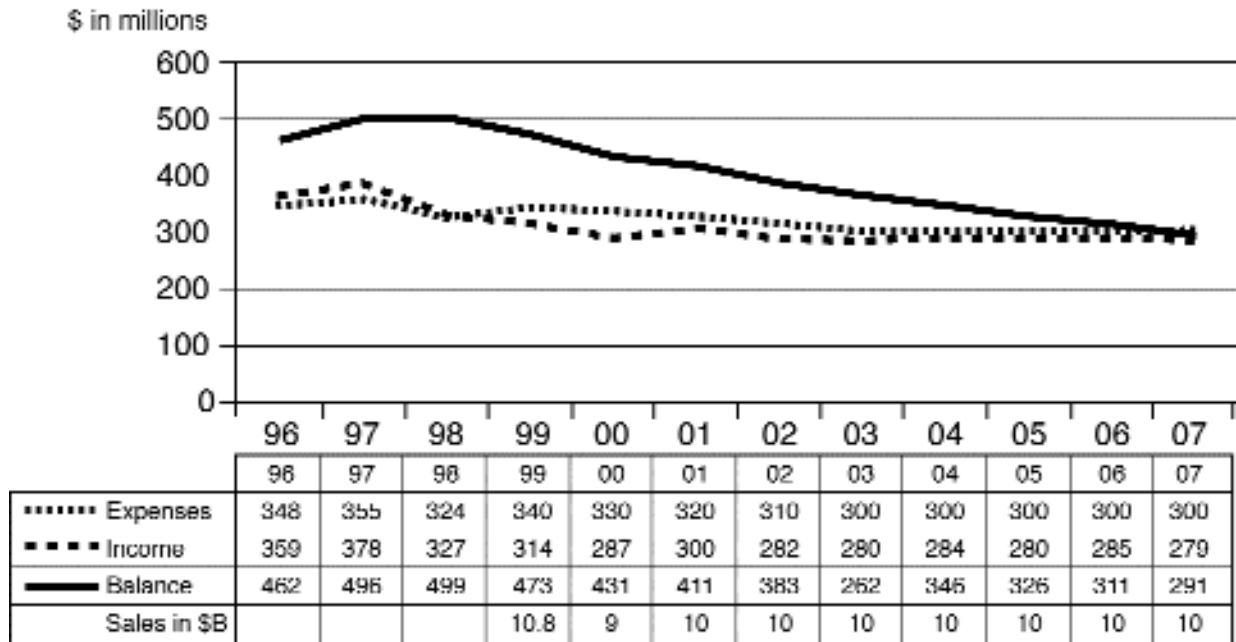
Administrative Account Continued Solvency

At the 2.5% rate, which was changed as a result of DSCA's annual review and its continuing efforts to streamline the FMS process, the financial position of the administrative fund will remain strong through the early years of the next decade. Table 2 shows that, allowing for a reduction to the 2.5 % rate, the FMS administrative account balance will remain at approximately \$300 million through FY 2007, a safety margin of almost one year of operating expenses.

Controlling Costs

Efforts to streamline the FMS process started in 1995 when DSCA observed that budgets were increasing over long term expected income levels. During this period, the Agency initiated a 5-year planning cycle with the military departments and CINCs to rationalize expenses with expected income. In other words, the Agency's goal is to reach an operating level where expenses equal income. Over the next four years, the DSCA plans to reduce the program budget by \$10 million each year from \$340 million in 1999 (See Table 3). As part of this effort, the military departments were tasked concurrently to re-engineer their respective organizations, processes and work year levels, so that the essential security cooperation mission would be accomplished within the prescribed funding levels.

Table 2
Administrative Fund Status 2.5% Rate Effective Mid-FY99
Current President's Budget 2000 Sales Estimate



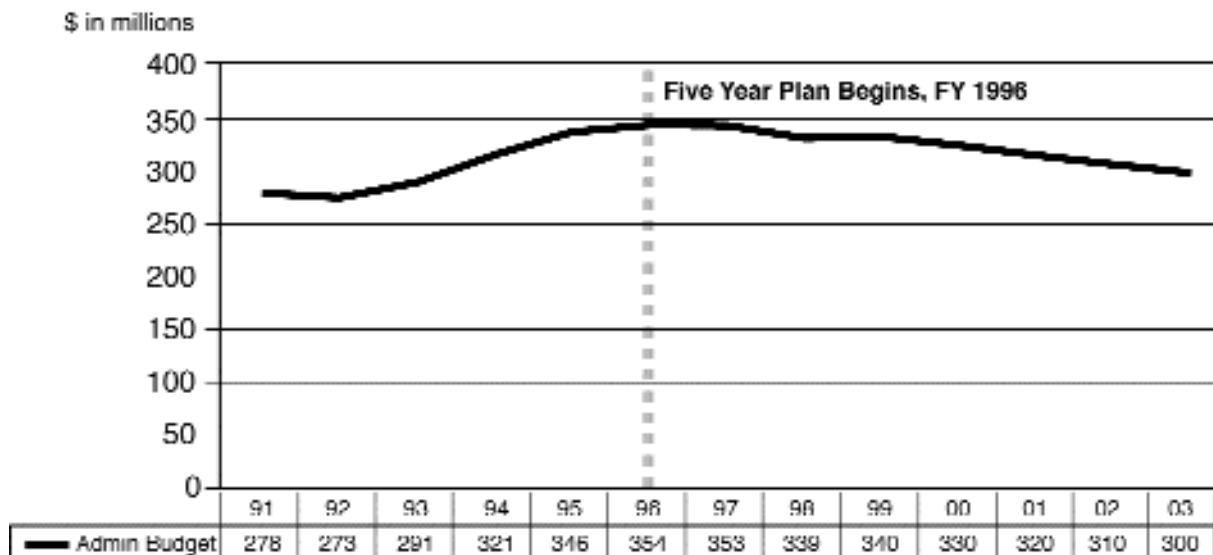
Re-engineering Efforts

In recent months, the security cooperation system has been under increased scrutiny. Some FMS customers have criticized the system's high cost and inflexibility. Greater customer and industry participation, improved timelines, and reduced costs have been looked to as goals to be achieved by re-engineering. The DSCA, in conjunction with the MILDEPs and defense agencies, is leading the security cooperation community in an aggressive plan to re-engineer FMS processes. A specific initiative is to substantially reduce program-operating costs below current levels. Such reductions will stem from the elimination of organizational and operational duplication throughout the department and more cost-effective use of outsourcing alternatives.

General Davison made the following statement at the Defense Security Cooperation Reform Day:

...we have begun implementing several of the recommendations from the white papers on process transparency and on cost recovery. The arms transfer process white paper is nearing completion. Over the coming months, DSCA will be developing a white paper on metrics and business process reengineering. We are also hard at work on improving how DoD handles its part of the national disclosure and export licensing Processes. And we are working with State Department on these same issues.

Table 3
Five Year FMS Budgets



Customer satisfaction has taken on a new meaning in today's global arena as government and businesses devise ways and means to justify and sustain their continued survival. The benefits and savings derived from reducing redundancies and increasing efficiencies will be passed on to the FMS customer. In fact, the economic benefits of the reduced administrative fee is clearly apparent and reflects DoD's commitment to major restructuring and process changes, to provide better quality and more cost effective services to its customers.

With this view in mind, the administrative rate reduction and ongoing streamlining and re-engineering efforts will improve the services the FMS program provides to foreign customers. This will be in the form of increased customer satisfaction and continued military-to-military contacts with foreign governments through FMS purchases.

Summary

Considering the dynamic forces at work in today's global marketplace, organizations are recognizing that, in order for them to be more responsive to the needs of buyers, the coming decade will demand much leaner and flexible organizational structures. These fluid organizations will allow managers and employees to adapt organizational arrangements more efficiently in fulfilling the requirements and expectations of sophisticated buyers.

Over the past several years, the Defense Security Cooperation Agency has been reviewing its organizational arrangement and evaluating the way it does business. The Agency is in the process of identifying specific reforms to strategically align itself during the 21st century.

Although the DSCA's re-engineering efforts are just starting, the Agency is going into the process with the mandate that it must make the system and the FMS process more responsive to the customer and eliminate redundancies in the organization. With those goals, any savings will be passed on to the FMS customers.

The decision to change the administrative surcharge shows that the DoD is putting out a financial marker to the FMS customers that it is committed to making needed changes to the FMS processes and infrastructure.

References

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